Money and Credit

Monetary policy

Price behavior over the course of 2007 reflected the continued effectiveness of monetary policy. The position adopted by the monetary authority was designed to make it possible for the economy to absorb international financial market turbulence in the second half of the year without significant trauma, while avoiding deterioration of internal expectations in response to the sharp rise in farm prices. The result of this posture was to strengthen the conditions required to maintain annual IPCA growth – the third smallest variation since the series was first calculated in 1980 – well within the target range stipulated by the National Monetary Council (CMN) in the framework of the inflation targeting system.

In early 2007, the Central Bank Monetary Policy Committee (Copom) continued its strategy of applying a more flexible monetary policy. Consequently, in its ordinary meetings held early in the year, the Committee adopted three successive 25 basis point reductions in the Selic rate target. Though this pace of reduction could be considered somewhat conservative compared to the previous year's trajectory, when cutbacks of 75 basis points were adopted at each one of the first three ordinary meetings, followed by five successive reductions of 50 basis points, it was in fact the most appropriate position that could have been adopted by the Committee in light of the upturn in price indices toward the end of 2006.

In early 2007, price behavior reflected the impact of growth in the external prices of the major commodities, together with the effects of expanding employment, income and credit levels, government transfers and other fiscal drivers that had marked 2006 and were expected to continue through 2007. Parallel to these factors, mention should be made of the delayed impact of the 650 basis point reduction registered in the Selic rate in 2006.

In this framework, the reductions adopted by Copom during the first three 2007 meetings were a reaction to the perception that the short-term price high was caused basically by transitory factors. Aside from this, the Committee concluded that the external scenario remained favorable, particularly with regard to the outlook for financing the Brazilian economy, despite expectations of lesser global liquidity, caused by rising interest rates in the industrialized economies, coupled with increased global market volatility.

At its June and July meetings, Copom concluded that the recent evolution of inflation was consistent with the established targets, in contrast to the relatively high rates that had persisted since the end of 2006. It was also determined that the higher than initially thought contribution of the external sector to consolidation of a benign inflation scenario, particularly as a result of the discipline imposed on the prices of tradables and of increased investments, had established the conditions required for growth in aggregate demand and for internal supply to return to a state of equilibrium over a period of time considered important to monetary policy decisions, without in any way jeopardizing the process of convergence to the inflation target trajectory. Thus, it was decided that the pace of cutbacks in the Selic rate target would be quickened, as evinced in successive reductions of 50 basis points.

In its final three meetings of the year, Copom concluded that the evolution of the world economic scenario and the upturn in the pace of domestic economic activity justified reductions in monetary incentives. In September, despite the understanding that various factors existed that would recommend a decision not to alter interest rates at that meeting, the Committee determined that the balance of the risks to the prospective inflationary trajectory still justified an additional monetary stimulus, expressed as a 25 basis points reduction in the Selic target. Starting in October, reflecting perceptions that the increased probability of initially localized inflationary pressures could become a risk to the trajectory of domestic inflation and considering that the favorable impact of the external sector on inflation in the sector of tradables could be neutralized by upward pressures generated by rising domestic demand on the prices of nontradables in an environment of expanding credit and real overall wages, Copom opted to maintain the inflation target rate of 11.25% per year.

Federal public securities and Central Bank open market operations

Primary National Treasury operations with federal public securities resulted in net placements of R$7.3 billion in 2007, with maturities of R$349.7 billion, anticipated redemptions of R$24.7 billion and placements of R$357 billion in Internal Federal Public Securities Debt (DPMFi). Exchanges made for the purpose of lengthening the terms of maturing debt totaled R$134.6 billion, of which 39.9% were National Treasury Bills (LTN).

In the month of January, the National Treasury released the 2007 Annual Financing Plan (PAF), highlighting the strategies adopted in order to lengthen average maturities; smooth the maturity profile; substitute securities indexed to exchange and the Selic rate with fixed-rate and inflation-linked securities; and develop the forward interest rate structure for federal public securities on internal and external markets. It should be noted that, since January 2007, the Treasury has refrained from offering 18-month LTN, while adopting a 12 and 24-month maturity horizon. At the same time, the maximum maturity for National Treasury Notes – Series F (NTN-F) was set at 10 years, compared to the previous level of seven years. With these conditions, as of early 2007, the issuing structure of fixed-rate securities posted benchmarks of 6, 12 and 24 months for LTN and 3, 5 and 10 months for NTN-F.

Over the course of the year, the average DPMFi maturity increased gradually to a level of 36.5 months in December, against 31 months in January. At the same time, the profile of the stock held by the public moved into an unprecedented position at the end of the year, as fixed-rate securities assumed a position higher than floating-rate securities, with 37.3% and 33.4%, respectively, against 36.1% and 37.8% at the end of 2006. The participation of inflation-linked securities reached 26.3% of total DPMFi, against 22.5% at the end of 2006.

Graph 2.1
Average term of the federal public securities debt

Gross issuances of LTN and NTN-F totaled R$139.4 billion and R$79.2 billion, respectively, in 2007, while those involving National Treasury Financing Bills (LFT), which are tied to the Selic rate, totaled R$81.7 billion. Placements of National Treasury Notes – Series B (NTN-B), referenced to the IPCA, reached a level of R$56.7 billion, accounting for the totality of issuances linked to price indices. This should be viewed against the fact that the PAF defined the Treasury's strategy of not offering National Treasury Notes – Series C (NTN-C), which generate earnings according to the General Price Index – Market (IGP-M), in 2007.

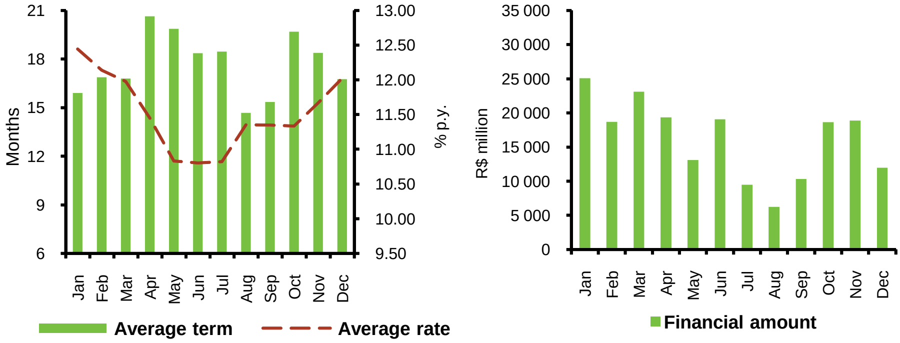
The measures taken by the monetary authority regarding the banking reserve market consisted basically of withdrawing resources from the economy or injecting resources in order to maintain the effective Selic rate at levels close to the nominal targets defined by Copom at its eight 2007 meetings.

The daily average balance of financing and go-around operations carried out by the Central Bank increased from R$11 billion in December 2006 to R$11.4 billion

Graph 2.2

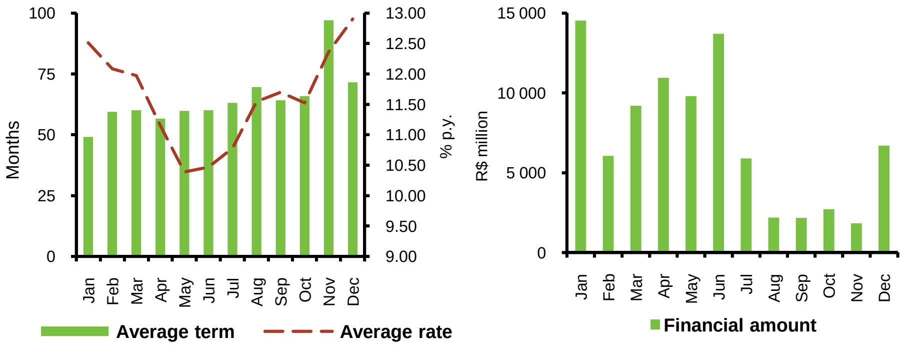
Auctions of federal public securities – 2007

LTN



Auctions of federal public securities – 2007

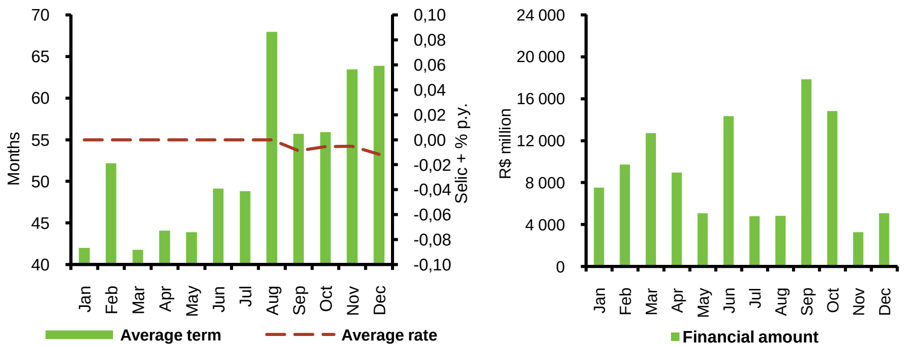
NTN-F



Graph 2.3

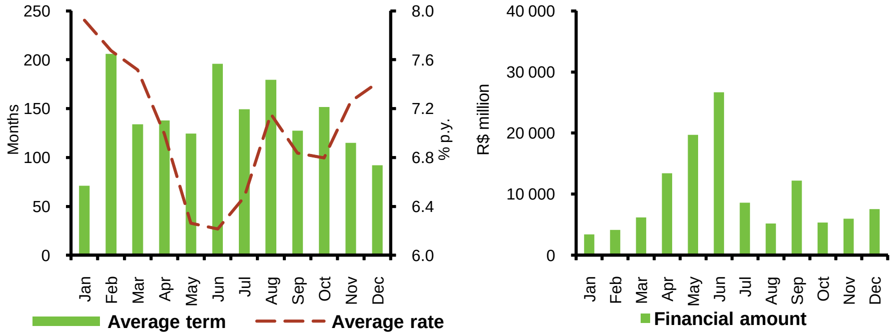
Auctions of federal public securities – 2007

LFT



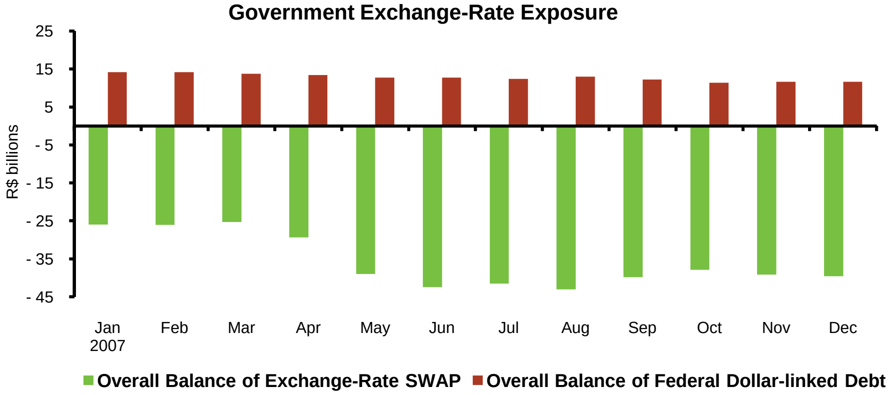
at the end of 2007, while the balance of five-month operations declined from R$30.8 billion to R$17.2 billion. Moving in the opposite direction, the average daily balances of operations with maturities from two weeks to three months and seven months increased in that order from R$2.5 billion to R$82.4 billion and from R$23.7 billion to R$65.9 billion.

Graph 2.4
Auctions of federal public securities – 2007
NTN-B



The daily average of the Central Bank net financing position on the open market reached R$177.3 billion at the end of 2007, compared to R$68.1 billion in the corresponding period of 2006. Despite the turbulence that hit international financial markets as of the middle of the year, the internal financial market managed to maintain a comfortable level of liquidity. The increase in the monetary authority's net financing position was to some extent connected to sterilization of exchange acquisitions by the Central Bank, which totaled R$155.4 billion in the year, as well as to adjustments in the margin of operations involving exchange swaps generating a financial flow of R$8.8 billion for the public holding these derivative contracts. Going in the opposite direction, operation of the Single Operating Account at the Central Bank produced a contractionary impact of R$55.6 billion, revealing the primary surplus registered during the year. Once operations with federal public securities are incorporated, the negative monetary impact came to R$74 billion.

Graph 2.5
Government Exchange-Rate Exposure

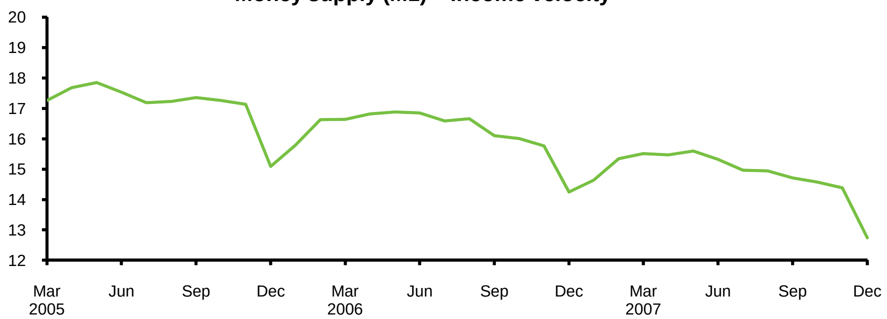


In order to ensure consolidation of the asset position in federal public debt exchange exposure and minimization of exchange rate volatility, reverse exchange swap offers carried out by the Central Bank totaled US$24.6 billion over the course of 2007, while redemptions came to US$15.9 billion. These net placements of US$8.7 billion were reflected in a reduction from -1.1% at the start of the year to -2.3% of the share of DPMFi exposed to exchange rate variations. In nominal terms, government exchange exposure, understood as the difference between the balance associated to the remaining share of public exchange securities and the stock of derivatives, further accentuated the downward trend evident since January 2006, closing 2007 with a negative position of R$28.4 billion.

Monetary aggregates

Monetary aggregates mirrored the accentuated dynamics of economic activity in 2007, particularly as regards expansion of lending operations and external resources inflows. In this framework, the average daily balances of the money supply, viewed in the restricted concept (M1), reached R$210.5 billion in December, an increase of 25.9% in the year. At the component level, the balance of currency held by the public increased 18.2% in the year, while demand deposits expanded 31.1%. Viewed in terms of seasonally adjusted data deflated by the IPCA, the M1 balance expanded 22.2% in 2007, as a result of real growth in wages, the performance of credit operations and expanded federal government income transfer programs. Income velocity of the aggregate remained stable during the year, at a level compatible with the overall scenario.

Graph 2.6
Money supply (M1) – Income velocity[1/]

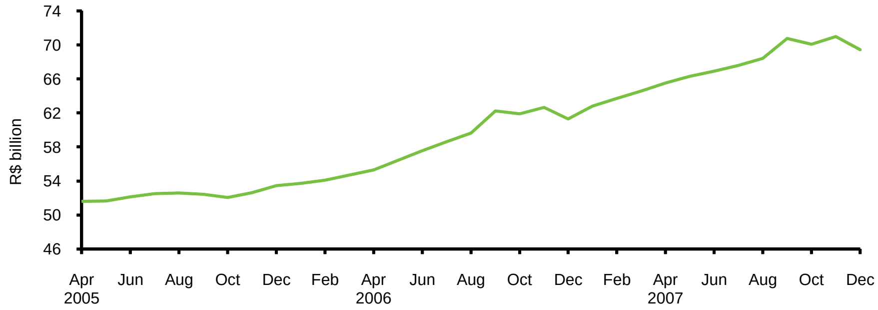


1/ Defined as the ratio between twelve-month accumulated GDP (valuated by IGP-DI) and the average balance of the monetary aggregate.

Using the concept of average daily balances, the monetary base accompanied evolution of the money supply, reaching R$143.6 billion in December. Annual growth of 21.4% reflected increases of 19% in the average balance of currency and 27.1% in banking reserves.

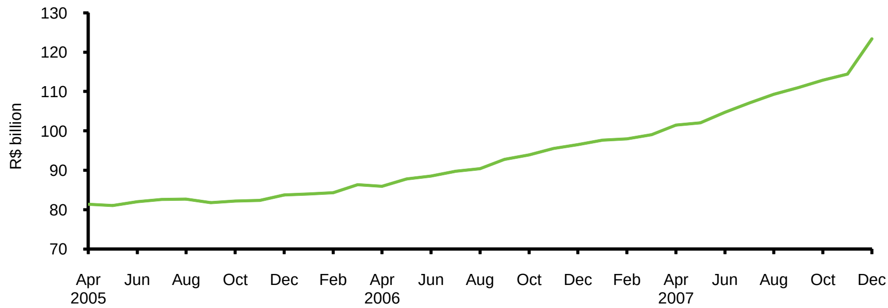
Reflecting net Central Bank exchange purchases on the interbank market, foreign sector operations generated an expansionary impact of R$155.4 billion on the monetary base, reflecting a 108.9% increase over the 2006 position. Parallel to this, monetary growth consequent upon adjustments in derivative operations implemented through exchange swaps – a mechanism for offering exchange hedge to the market – came to a total of

Graph 2.7
Currency outside banks – Seasonally adjusted at December 2007 prices[1/]



1/ Price index: IPCA.

Graph 2.8
Demand deposits – Seasonally adjusted at December 2007 prices[1/]



1/ Price index: IPCA.

R$8.8 billion. Moving in the opposite direction, National Treasury operations, excluding security operations, produced an annual contractionary flow of R$55.6 billion, while deposits resulting from additional requirements on deposits and compulsory reserves on the resources of the Brazilian System of Savings and Loans (SBPE) generated contraction of R$10.4 billion. Measures taken by the Central Bank to adjust the liquidity of the economy resulted in net sales of R$74 billion.

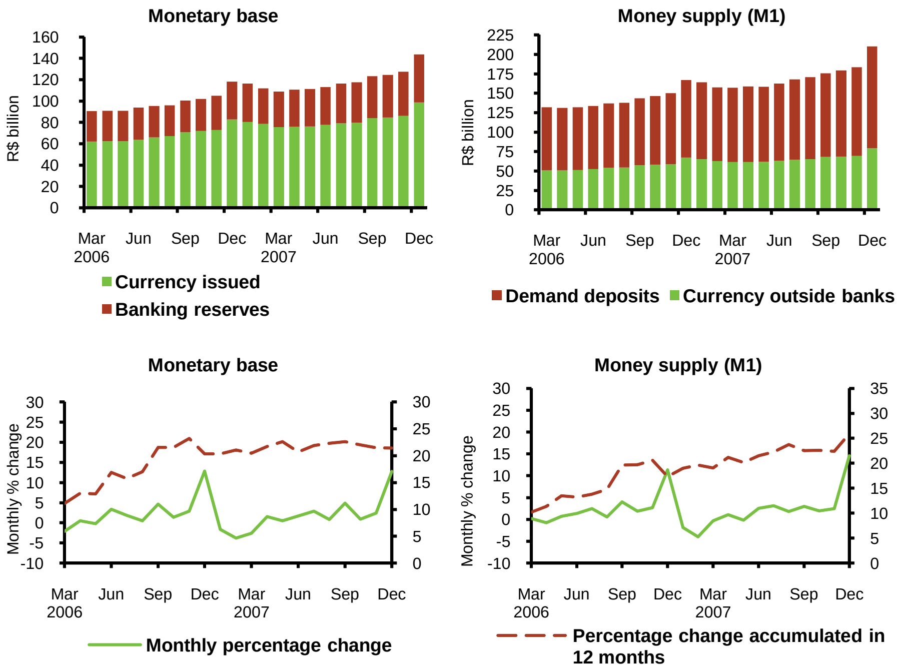
The expanded monetary base, which incorporates the restricted base, compulsory deposits in cash and federal public securities outside the Central Bank, totaled R$1.6 trillion at the end of 2007, an increase of 20.9% in 12 months. For the most part, this behavior reflected the evolution of the federal securities debt held by the market, together with National Treasury measures aimed at attenuating the monetary impact of external sector operations.

In the M2 concept, the money supply expanded 18.1% in the year, emphasizing 24.9% growth in the balance of savings accounts, driven by net inflows of R$33.4 billion. Private securities registered growth of 5.2%, reflecting net redemptions of R$15.1 billion in time deposits.

Graph 2.9

Monetary base and money supply (M1)

Average daily balances



The M3 monetary aggregate expanded 17.4% in the year, for 16% growth in the balance of investment fund quotas, with net inflows of R$21.3 billion. Annual growth of M4, which totaled R$1.9 trillion at the end of 2007, reached 20.9%, led by 47.7% expansion in the balance of federal securities on the market.

Table 2.1 – Collection rate on mandatory reserves

Percentage

Period		Demand deposits[1/]	Time deposits[1/]	Savings deposits[1/]	Credit operations	FIF Short-term	FIF 30 days	FIF 60 days
Prior to Real Plan		50	-	15	-	-	-	-
1994	Jun[2/]	100[2/]	20	20	-	-	-	-
	Aug	" [2/]	30	30	-	-	-	-
	Oct	" [2/]	"	"	15	-	-	-
	Dec	90[2/]	27	"	"	-	-	-
1995	Apr	" [2/]	30	"	"	-	-	-
	May	" [2/]	"	"	12	-	-	-
	Jun	" [2/]	"	"	10	-	-	-
	Jul	83	"	"	"	35	10	5
	Aug	"	20	15	8	40	5	0
	Sep	"	"	"	5	"	"	"
	Nov	"	"	"	0	"	"	"
1996	Aug	82	"	"	"	42	"	"
	Sep	81	"	"	"	44	"	"
	Oct	80	"	"	"	46	"	"
	Nov	79	"	"	"	48	"	"
	Dec	78	"	"	"	50	"	"
1997	Jan	75	"	"	"	"	"	"
1999	Mar	"	30	"	"	"	"	"
	May	"	25	"	"	"	"	"
	Jul	"	20	"	"	"	"	"
	Aug	"	"	"	"	0	0	"
	Sep	"	10	"	"	"	"	"
	Oct	65	0	"	"	"	"	"
2000	Mar	55	"	"	"	"	"	"
	Jun	45	"	"	"	"	"	"
2001	Sep	"	10	"	"	"	"	"
2002	Jun	"	15	"	"	"	"	"
	Jul	"	"	20	"	"	"	"
2003	Feb	60	"	"	"	"	"	"
	Aug	45	"	"	"	"	"	"

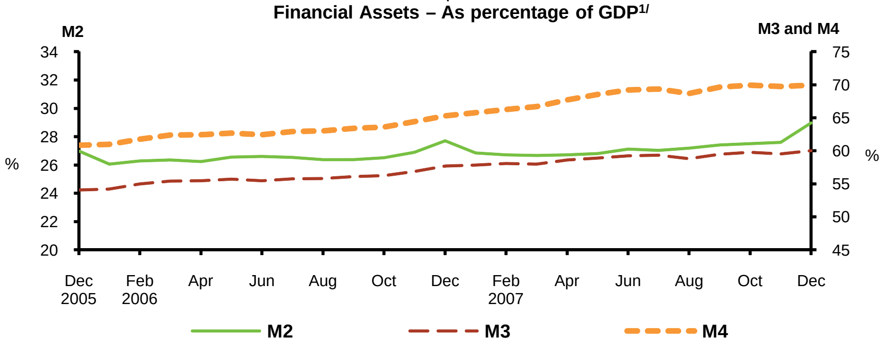
1/ As of August/2002, a new additional requirement on demand resources (3%), time deposits (3%) and savings deposits (5%) became effective. As of October/2002, rates for additional requirements on demand resources, time deposits and savings deposits moved to 8%, 8% and 10%, in that order.

2/ From June/1994 to June/1995 the 100% and the 90% rates refers to in addittional collection in relation to the base-period wich was calculated between June 23 and 30, 1994.
As of July 1995, the levying of compulsory deposits refers only to the arithmetic median of daily balances in each calculation period.

Table 2.2 – Financial assets

End-of-period balance					R$ billion
Period		M1	M2	M3	M4
2006	Jan	130.0	567.3	1 179.5	1 327.2
	Feb	131.1	574.9	1 202.2	1 349.7
	Mar	128.7	578.8	1 217.8	1 370.8
	Apr	127.5	579.7	1 225.5	1 379.3
	May	130.9	594.0	1 245.9	1 401.1
	Jun	132.1	600.4	1 252.5	1 409.3
	Jul	133.6	604.8	1 271.6	1 434.7
	Aug	136.3	607.0	1 283.7	1 450.3
	Sep	143.1	611.9	1 301.9	1 471.3
	Oct	145.0	622.4	1 320.2	1 493.8
	Nov	151.9	637.7	1 348.1	1 527.4
	Dec	174.3	661.5	1 377.7	1 558.6
2007	Jan	155.6	645.8	1 391.5	1 582.0
	Feb	153.7	647.0	1 406.5	1 604.2
	Mar	155.6	650.7	1 413.8	1 627.1
	Apr	156.5	657.1	1 441.0	1 664.6
	May	157.9	663.9	1 459.0	1 697.7
	Jun	164.2	677.2	1 478.8	1 727.8
	Jul	166.9	682.6	1 499.1	1 752.3
	Aug	170.0	698.1	1 509.4	1 762.1
	Sep	174.8	711.7	1 545.2	1 809.0
	Oct	178.1	722.4	1 569.7	1 836.6
	Nov	187.8	735.2	1 585.6	1 856.9
	Dec	231.4	781.3	1 617.6	1 884.8

Graph 2.10
Financial Assets – As percentage of GDP[1/]



1/ Last twelve month GDP at prices of indicated month (deflator: centered IGP-DI) based on the series released by IBGE.

Financial system credit operations

Financial system credit operations expanded sharply in 2007, a tendency considered consistent with downward movement in interest rates and the impact of consolidation of the nation's economic stability on consumption and investment decisions. In this context, marked by longer maturity terms and stability in default levels, particular mention should be made of household consumer financing operations, driven by improved labor market conditions. This was particularly true in the segment of auto loans, an area in which the participation of leasing operations increased sharply. In much the same way, credits channeled to the business segment registered strong growth, led by disbursements for working capital and investment operations, despite the ongoing efforts by large scale companies in pursuit of alternative long-term sources of financing.

Financing based on nonearmarked and earmarked resources totaled R$936 billion at the end of 2007, for annual growth of 27.8% against 20.7% in the previous year. The ratio between the total volume of loans and GDP closed at 34.7%, the highest level since July 1995, compared to 30.7% at the end of 2006.

Classification of credits according to the capital control of financial institutions shows that operations contracted with private national banks expanded 35.7% in the year, reaching R$410 billion, or 43.8% of total credits granted by the financial system. These operations were concentrated mainly in the segments of personal loans, industrial credits and operations with other services. Loans by public institutions totaled R$318.9 billion, 34.1% of the total portfolio, with growth of 18.7% in the year. Here, particular mention should be made of expanded operations with industry and individual borrowers. Financing granted by foreign banks reflected increased demand on the part of individual borrowers, industry and other services, with growth of 27.9% in the period, accounting for 22.1% of total loans granted by the financial system.

Table 2.3 – Credit operations

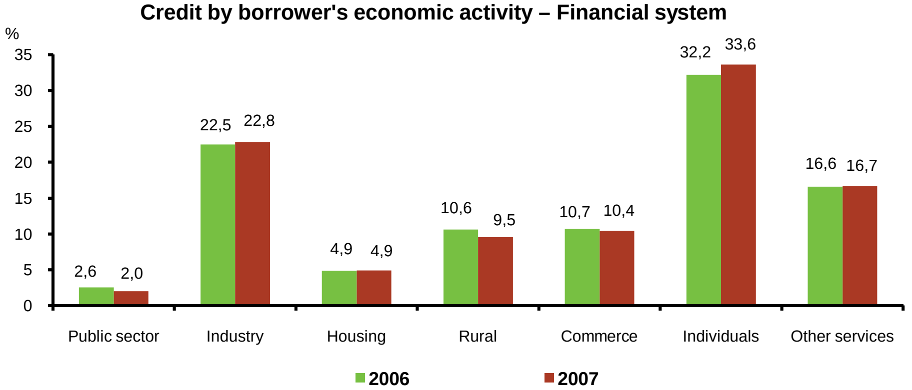
R$ billion

Itemization	2005	2006	2007	% growth
Total	607.0	732.6	936.0	27.8
Non-earmarked	403.7	498.3	660.8	32.6
Earmarked	203.3	234.3	275.2	17.5
% participation:				
Total/ GDP	28.1	30.7	34.7	
Non-earmarked/GDP	18.7	20.9	24.5	
Earmarked/GDP	9.4	9.8	10.2	

The volume of credits targeted to the private sector, including both nonearmarked and earmarked resources, totaled R$917.1 billion in December, reflecting growth of 28.5% compared to the same period of 2006. A sectoral breakdown indicates that operations contracted with individual borrowers totaled R$314.3 billion, for annual growth of 33.3%, reflecting the performances of personal loans and auto loans.

Loans targeted to the industrial segment expanded 29.9% in the year, adding up to a total of R$213.8 billion, with strong participation of the segments of energy, mining and agribusiness. Operations carried out with the segment of other services climbed to R$156.3 billion, reflecting annual growth of 28.6%. Here, it is important to emphasize the participation of telecommunications, credit card administration companies and transportation. Financing targeted to commerce increased 24.5% over 12 months, closing at R$97.6 billion, with increased demand in the segments of department stores and the automotive and food sectors.

Graph 2.11
Credit by borrower's economic activity – Financial system



The housing credit portfolio, which includes individuals and housing cooperatives, totaled R$45.9 billion in December, for an annual increase of 28.5%. The strong performance registered in this segment, which incorporates longer-term financing, mainly reflected the impact of consolidation of Brazilian economic stability on decisions regarding real estate demand and investments in this sector. Cumulative disbursements of savings account resources in 2007 expanded at an annual rate of 92.1%, totaling R$17.6 billion, of which 90.7% were granted according to the rules governing the Housing Finance System and 9.3% at market interest rates. Flows granted with Employment Compensation Fund (FGTS) resources targeted specifically to the financing of housing for the low income population totaled R$5.9 billion in 2007, reflecting a reduction of 13.7% compared to the previous year, though still higher than in the years prior to 2006.

Operations contracted with the rural sector reached R$89.2 billion in December 2007. Here, it is important to stress that the 14.8% increase registered in the year resulted from recovery in the crop/livestock sector. Loans targeted into current expenditure and investment operations and driven by obligatory funding and government fund and program resources expanded 15.7% and 11.6%, in that order, while those involving marketing operations expanded 9.2%. Credits granted in the form of working capital for the agribusiness sector increased 86.3% in the period.

Total credits channeled to the public sector added up to R$18.8 billion at the end of 2007, reflecting a 0.2% drop compared to the previous year. Financing contracted with the federal government declined 14.5% during the period, reflecting amortizations and exchange appreciation in contracts with gas, petroleum and electricity generation companies. In the opposite sense, the banking debt of state and municipal governments increased 3.9% to a level of R$15.2 billion, concentrated in operations with companies from the electricity and basic sanitation sectors.

Growth in credits to the public sector was tied to demand for funding for infrastructure projects, particularly electricity and basic sanitation. In this framework, mention should be made of the fact that the supply of resources for infrastructure investments was maintained, as demonstrated by the authorization granted since August for the financial system to grant new financing to *Centrais Elétricas Brasileiras* (Eletrobrás), following the schedule that defined 2007 disbursements at R$590 million, rising to a level of R$1.8 billion in December 2010. Parallel to this, on June 13, 2007, an additional source of funding was created in order to make it possible to channel financing into basic sanitation projects. This was done by increasing the base capital of the Federal Savings Bank (CEF), since that institution did not have a sufficient operational margin to grant the amount intended by the federal government to states, municipalities and their controlled companies in the form of lending operations. Consequently, as of January 2008, investment of resources up to the limit of R$6 billion was permitted in activities related to environmental sanitation in the framework of public sector-supported programs.

The volume of credits based on nonearmarked resources totaled R$660.8 billion in December, for annual growth of 32.6%, driven by 33.4% expansion in credits targeted to individual borrowers with a total of R$317.6 billion. This result represented 70.6% of total financial system credits.

Aside from growth in reference credits, the sharp expansion of operations with individual borrowers accounted for the 117.2% increase in leasing operations, with a total of R$30.1 billion at the end of 2007. Loans granted to cooperatives increased to 27.9% in the year, closing at R$12.5 billion.

The performance of reference credits reflected 34.3% growth in payroll-deducted loans and 28.4% in auto loans, the balances of which closed 2007 at R$64.7 billion and R$81.5 billion, respectively.

Table 2.4 – Non-earmarked credit operations

R$ billion

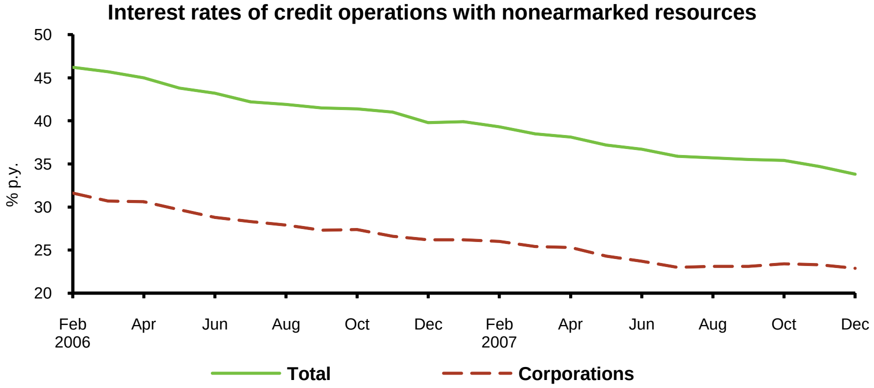
Itemization	2005	2006	2007	% growth
Total	403.7	498.3	660.8	32.6
Corporat e entities	213.0	260.4	343.2	31.8
Domestic funding	164.9	207.8	274.7	32.2
Reference credit[1/]	137.3	165.0	214.9	30.2
Leasing	12.8	20.6	34.8	69.1
Rural	2.1	1.4	2.0	40.2
Others	12.7	20.7	23.0	10.8
External funding	48.1	52.6	68.6	30.3
Individuals	190.7	238.0	317.6	33.4
Reference credit[1/]	155.2	191.8	240.2	25.2
Credit cooperative	8.3	9.8	12.5	27.9
Leasing	8.4	13.9	30.1	117.2
Others	18.8	22.5	34.7	54.3

1/ Interest rate reference credit, defined according to Circular 2,957 dated 12.30.1999.

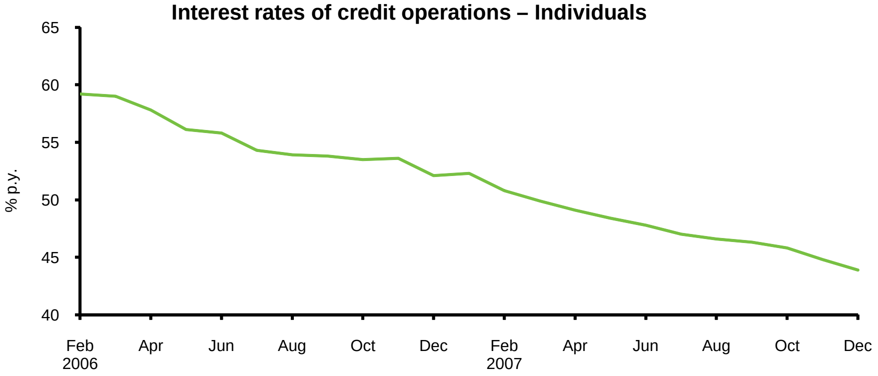
Corporate loans added up to R$343.2 billion in December, for growth of 31.8% in the year. The modalities contracted with domestic resources reached R$274.7 billion, reflecting 32.2% growth in the period. For the most part, this result was tied to 30.2% growth in reference credit operations, which accounted for 78.2% of total domestic resources. In this case, one should highlight 43.7% growth in working capital operations, the principal modality in this credit segment. Operations based on external resources expanded 30.3% in the year, with increases of 30.7% in external onlending operations and 22.3% in Advances on Exchange Contracts (ACC).

Average interest rates in credit reference operations followed a downward trajectory over the course of 2007, including the period following the October interruption of the process of reducing the basic rate of interest. It is important to mention that information on these operations is based on the terms of Circular no. 2,957, dated December 30, 1999.

Graph 2.12
Interest rates of credit operations with nonearmarked resources



Graph 2.13
Interest rates of credit operations – Individuals

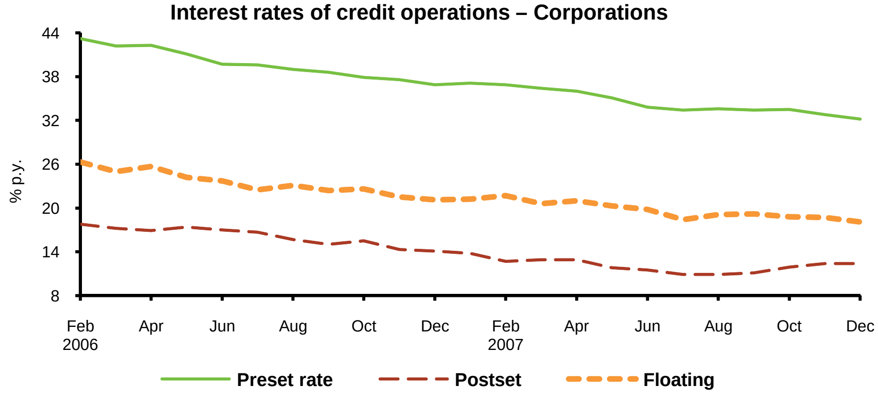


The average rate on loans dropped 6 p.p. in the year, closing at 33.8% per year, the lowest rate ever registered in the historical series which began in June 2000.

The average rate of interest practiced in household financing operations closed at 43.9% per year in December, the lowest level in the historical series which began in July 1994 and 8.2 p.p. below the level registered at the end of 2006. This performance was even more significant in the modality of personal loans, particularly as a result of the high level of participation of payroll-deducted credits in this modality. These operations – it should be stressed – are offered at sharply lower rates of interest since the risk involved is much lower.

The average rate of interest on corporate loans declined 3.3 p.p. in the year, closing at 22.9% per year in December, the lowest level since the series was first calculated in June 2000. This reduction was even sharper in financing operations based on fixed-rate and floating interest rates, which registered respective averages of 32.2% per year and 18.1% per year, the lowest rates ever registered.

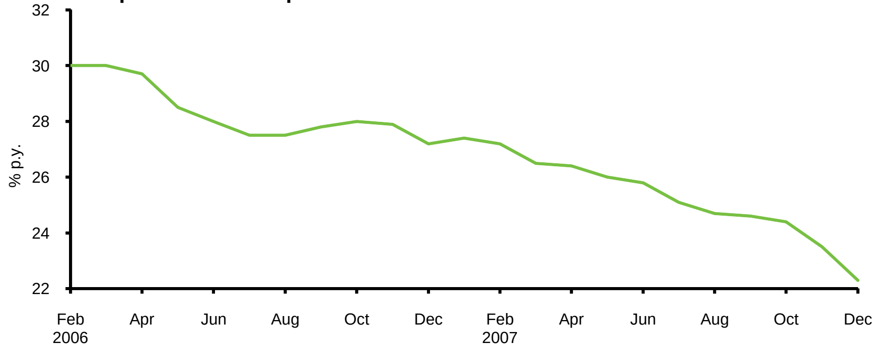
Graph 2.14
Interest rates of credit operations – Corporations



The banking spread in credit reference operations dropped 4.9 p.p. over the course of 2007, reaching 22.3 p.p. in December, the lowest level in the historical series which first began in 2000. During the period under analysis, reductions in the spread were registered in operations with individual borrowers, 7.7 p.p. and with corporate entities, 1.6 p.p., closing at respective levels of 31.9 p.p. – the lowest mark since the series was first calculated in July 1994 – and 11.9 p.p. at the end of 2007.

Graph 2.15

Spread of credit operations with nonearmarked resources

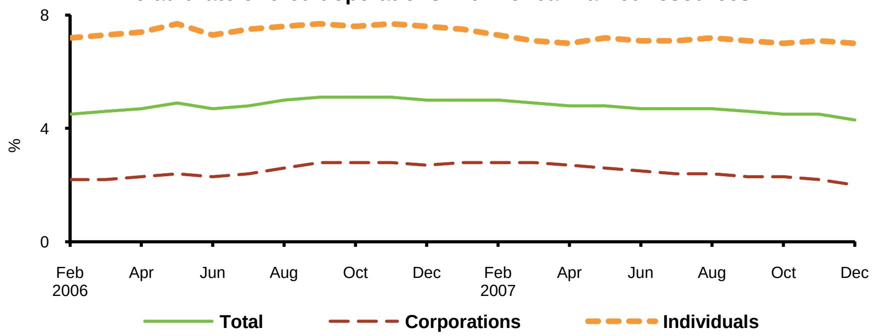


The average maturity of loans related to the reference credit modality, which corresponds to average periods to maturity of the balance or remaining shares of ongoing operations, reached 350 days in December 2007, the highest level in the historic statistical series, against 296 days in the same month of 2006. The average maturity of the corporate portfolio expanded 41 days to a level of 275 days, while that of financing granted to individuals closed at 439 days, with annual growth of 71 days in the year. The levels achieved in both segments corresponded to the longest average terms registered since June 2000.

Default levels in the reference credit portfolio, including only arrears of more than 90 days, closed 2007 at 4.3%, the lowest level since December 2005, reflecting a 0.7 p.p.

Graph 2.16

Default rate of credit operations with nonearmarked resources1/



1/ Portifolio's percentage share in arrears of more than 15 days.

reduction compared to the corresponding previous period. This movement reflected reductions of 0.7 p.p. in the corporate portfolio and 0.6 p.p. in the personal loan portfolio, registering respective rates of 2% and 7%.

Credit operations based on targeted resources totaled R$275.2 billion at the end of 2007, for annual growth of 17.5%. This evolution reflected both the performance of rural and housing sector operations, and 15.1% growth in BNDES financing operations, which totaled R$160 billion at the end of the year, distributed in a balanced way among direct operations and credits through financial institutions.

Table 2.5 – Earmarked credit operations

R$ billion

Itemization	2005	2006	2007	% growth 2007/2006
Total	203,3	234,3	275,2	17,5
BNDES	124,1	139,0	160,0	15,1
Direct	66,3	71,7	77,8	8,5
On lendings	57,8	67,3	82,2	22,1
Rural	45,1	54,4	64,3	18,2
Banks and agencies	43,3	51,9	60,7	16,9
Credit unions	1,8	2,4	3,6	46,5
Housing	28,1	34,5	43,6	26,4
Others	6,0	6,4	7,3	14,3

In 2007, BNDES disbursements accumulated a total of R$64.9 billion. Annual growth of 26.5% was driven by the dynamics of PAC-related investments, targeted mainly to infrastructure. Credits granted to the segments of commerce and services increased 61%, reaching R$33.4 billion, concentrated mainly under land transportation, electricity and gas and construction. Financing to the crop/livestock sector increased 46%, while disbursements to industry declined 25%. Funding released to micro, small and medium businesses, which accounted for 25% of total 2007 BNDES disbursements, added up to R$16.1 billion, for growth of 45% in the period.

Consultations formalized with BNDES, representing both potential disbursements for medium and long-term business investments, totaled R$126.8 billion in 2007, for growth of 19.6% compared to the previous year. This performance was associated with growth of 29.3% in financing requests put forward by the segment of commerce and services, in a total amount of R$67.3 billion. This demand was, to a great extent, driven by the sectors of construction and land transportation. Consultations submitted by industry totaled R$54.3 billion, increasing 9.6% in the year. The leading segments were food products and coke, oil and fuels. Requests related to crop/livestock activity totaled R$5.2 billion, with growth of 17% in the period.

Table 2.6 – BNDES disbursements

			R$ million
Itemization	Jan-Dec		Growth
	2006	2007	(%)
Total	51 318,0	64 891,7	26,5
Industry	27 120,8	26 445,8	-2,5
Chemical	1 062,0	1 882,8	77,3
Ruber and plastic	472,7	1 124,9	138,0
Cellulose and paper	2 315,0	1 808,5	-21,9
Food products	3 385,2	4 504,1	33,1
Basic metallurgy	2 160,8	3 119,8	44,4
Motor vehicles	5 186,2	3 065,2	-40,9
Other transport equipment[1/]	4 222,7	1 699,6	-59,8
Commerce/Services	20 774,6	33 448,1	61,0
Land transport	7 197,6	11 472,3	59,4
Construccion	1 538,7	3 109,0	102,1
Telecommunications	2 133,7	3 379,2	58,4
Electricity and gas	4 789,8	8 056,3	68,2
Farming	3 422,6	4 997,8	46,0

Source: BNDES

1/ It includes aircraft industry.

Provisions set aside by the financial system added up to R$51.2 billion in December 2007. Annual growth of 11.7% was compatible with 27.8% expansion in the credit portfolio and resulted from increases in the provisions set aside by national private institutions, 14.2%, and foreign institutions, 22.1%, together with provisions by the public financial system, 4.3%. The ratio between the volume of provisions and overall credits reached 5.5%, against 6.2% in December 2006.

National Financial System

In the year under analysis, the National Financial System was able to preserve adequate liquidity, profitability and asset quality standards, even in the midst of intense international financial market volatility in the second half of the year. This sustainability reflected both the continued dynamics of internal demand as the force driving economic growth, and the measures adopted by the monetary authority to improve prudential regulation. Aside from this, it is important to highlight measures taken by the Central Bank to improve the quality of financial services, thereby enhancing competition among financial system institutions.

Credit operations represented 32.2% of total banking system assets, excluding intermediation, in December 2007. This was the same level registered at the end of 2006. The participation of stocks and securities dropped from 27.8% to 24.8% during the period, while the participation of interbank liquidity investments and exchange operations increased 3.9 p.p., closing at 20.6%.

Demonstrating the increased importance of other instruments in financial institution portfolios, particularly debentures and stocks, the participation of public securities in security portfolios declined from 73.2% at the end of 2006 to 65% in December 2007.

Accompanying growth in credit and leasing operations, revenues originating in these assets continued greater than those involving security investments, accounting for 55.1% of total financial intermediation in December 2007, against 52.7% in December 2006. In the same time span, the participation of revenues consequent upon securities and derivative instruments dropped from 41.5% to 39.7%.

With regard to sources of financing for intermediation activities, following the example of 2006, one should highlight growth in the participation of sources other than the classic instruments of deposits made by the public, consistent with the downward trajectory of domestic interest rates. In this scenario, while the joint participation of exchange market operations and interbank liquidity inflows (repo operations and interbank deposits) in total liabilities reached 41.7% in December 2007, against 37.2% in the corresponding period of the previous year, participation in total deposits obtained with the public, including demand deposits, time deposits and savings deposits, dropped from 33.8% to 29.6%.

The number of operating credit unions evolved from 1,452 institutions in December 2006 to 1,465 at the end of 2007, partly as a result of expansion of the population limit of the area in which cooperatives are allowed to operate with free admission of members from 750,000 to 2 million inhabitants, as determined in Resolution no. 3,442.

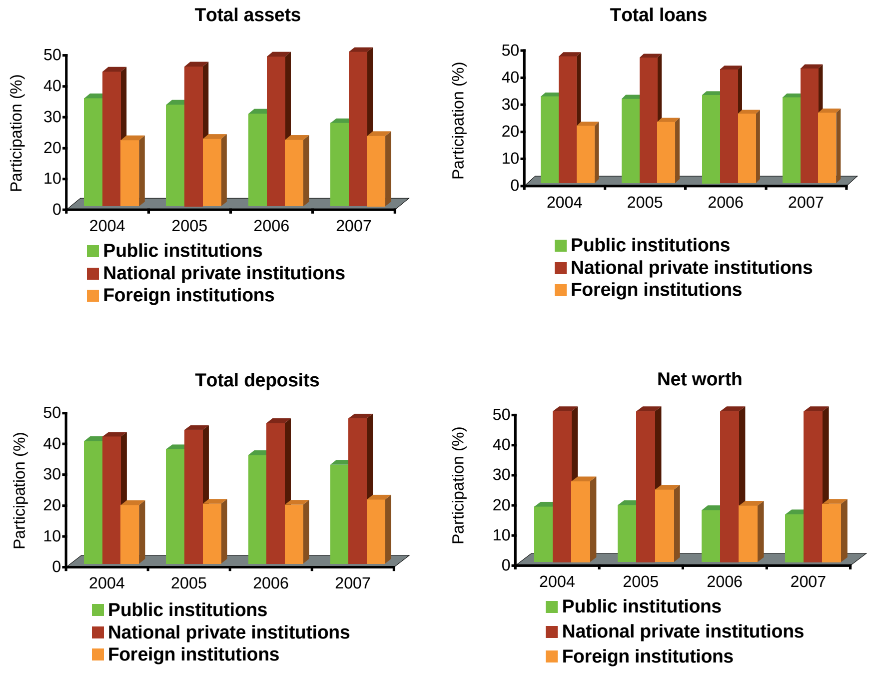
The participation of national private bank assets in the Brazilian banking system expanded from 48.5% in December 2006 to 50.3% in the corresponding months of 2007, while the participation of foreign banks shifted from 21.5% to 22.8%, and that of public banks dropped from 30% to 27%.

Insofar as prudential regulations are concerned, the monetary authority published new capital requirement rules for covering various types of risk inherent to financial intermediation, such as credit, market and operational risk. These rules are to go into effect as of July 2008, in the framework of adjustment to the Basel Accord II.

In this sense, Resolution no. 3,444 redefined Base Capital (PR), considered as the institutions own capital utilized in order to verify its compliance with the operational limits to which financial institutions are submitted. In order to avoid an artificial increase in the capitalization levels of the system, various deductions from PR were implemented by excluding tax credits to be received over periods of more than five years, together with

Graph 2.17

Banking System – Participation by segment1/



1/ Consider only banking institutions, not consolidated by conglomerates.

various instruments issued by other financial institutions. With respect to authorization for funding instruments to be included in PR, the possibility of including effectively paid-in amounts of hybrid capital and debt instruments in Tier I of PR, corresponding to the highest quality capital, was adopted, provided that certain conditions be fulfilled, among which one should cite a maximum level of 15% of that tier.

With regard to the new system of calculating capital requirements, Resolution no. 3,490 defined the concept of Required Base Capital (PRE), which is to be compared to the institution's own capital calculated according to PR in order to verify compliance with minimum capitalization levels as of July 2008. PRE corresponds to the minimum required capital of institutions for them to be able to absorb unexpected losses originating in the risks to which they are subjected. It is composed of the sum total of six components, each one of which is defined for coverage of a specific risk modality, as follows: credit risk, exchange exposure risk, interest rate exposure risk, commodity price variation risk, stock price variation risk and operational risk.

Growth in the flow of exchange market resources, particularly in the first half of 2007, impacted growth of the short position of banks. With the purpose of controlling leverage with these positions, Circular no. 3,352 reduced the PR limit from 60% to 30% for exposure in gold and in assets and liabilities referenced to exchange rate variations.

Parallel to this, Circular no. 3,353 increased capital requirements on exchange exposure from 50% to 100%. Starting in the month of August, the prudential effect of these measures and the reduction in the flow of exchange resources to the country impacted the reversal of the exchange position of banks, which shifted from a short to a long position, remaining there until the end of the year.

During the course of 2007, the Central Bank decreed the extrajudicial liquidation of four institutions: two brokerage companies, one stock and security distribution company and one group buyer management company. At the end of the year, 63 institutions remained subject to the special system of administration, seven less than at the end of the previous year.

Regarding the providing of banking services to the citizenry, Resolution no. 3,477 dealt with the position of the ombudsman as an organizational component of financial institutions. The role of this component is to ensure strict compliance with the rules governing consumer rights, while also providing a channel of communication between institutions and their clients. Therefore, the ombudsman is charged with receiving, recording, preparing, analyzing and giving formal treatment to complaints submitted by clients and product and service users, when such complaints are not resolved at the branch level or at any other of the institution's service outlets. The ombudsman should inform complainants of the time foreseen for a conclusive response, which is restricted to a maximum of 30 days. The services of the ombudsman should be made available free of charge, including free direct dialing in the case of institutions that have individual persons or organizations classified as microbusinesses among their clients.

In December, the monetary Authority published a series of rules disciplining the fees charged by financial institutions. Resolution no. 3,518 determined that the Central Bank of Brazil will define the standardization and uniformity of the headings used in fee tables for priority services provided to individual clients, thus making it easier for them to compare the prices charged by different institutions.

Resolution no. 3,516, prohibited the charging of fees as a result of early settlement of loan and lease contracts, at the same time in which it defined criteria for calculating the current value of amortization or settlement of such contracts. Previously, the absence of homogeneous criteria applied to anticipated settlement of credit operations made it difficult for borrowers to move from one institution to another offering more favorable cost conditions. This measure is part of the effort designed to encourage portability of credit and enhanced competition, while ensuring equity in relations and a reduction of informational asymmetry among agents.

Aside from this, Resolution no. 3,517 deals with the providing of information on the total effective cost corresponding to all charges and expenses involved in credit and leasing operations contracted by or offered to individual clients. The methodology for calculating this cost was defined, at the same time in which providing of this information to the public was made obligatory, together with the effective annual rate of interest charged on such operations.